RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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May 21, 1980 **LETTER 783**

May 9, DJIA 805.80; PTI 1121; A-D ratio –22.22
May 16, DJIA 826.54; PTI 1141; A-D ratio –21.31

THE PICTURE: You step out of your house and you note a large black cloud on the horizon. The size and blackness of the cloud bothers you, so you scurry back inside and shut all the windows. You take another look at the cloud, and you note that the cloud is nearer and it looks more ominous and even blacker than before. You check the house again, this time even locking the attic windows. You bring in a few houseplants that are outside. Then you take a third look, and the cloud is only a few miles away. Thunder and lightning are rumbling and flashing over the landscape. This time you take in the dog and cat, pull down the blinds, close the cellar door and batten all the hatches. Then you wait. You wait to see whether the storm hits you full or passes by, perhaps missing you by a mile or so.

The stock market works the same way. It's been very, very nervous since 1978. In late-1978 the market panicked, and in the space of two months it wiped out the gains of the previous two years. In late-1979 a second two-month panic wiped out all the gains of the previous 10 months. Then in February and March of this year a third two-month smash erased all the gains going back to late-1976 (I used the A-D ratio to measure gains or losses).

What was the market doing when it produced three panics in three successive years? In my opinion, it was simply battening down the hatches, playing it safe, taking out insurance in the same way as the fellow in the opening paragraph was insuring his house against the possibility of storm damage.

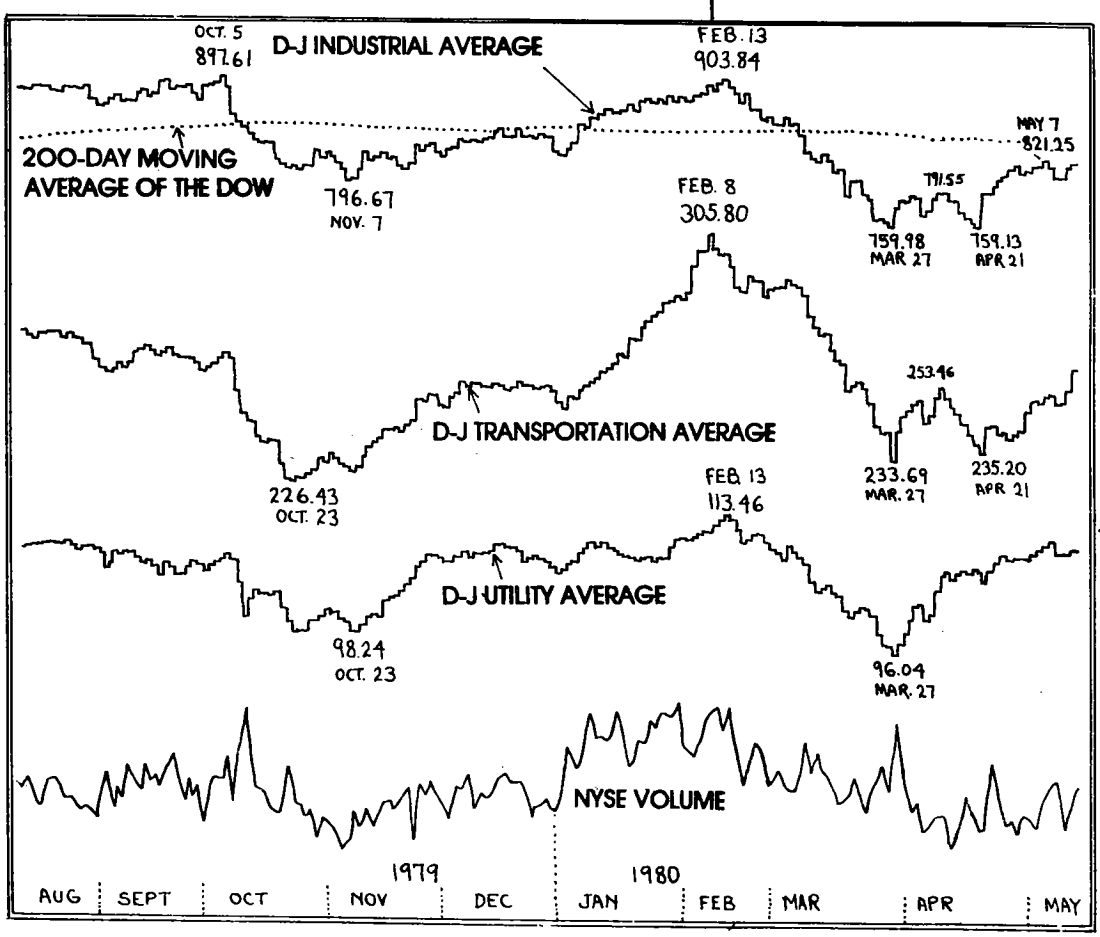
FRONT PAGE COMMENT: So far the recession has been greeted like an old friend who has arrived a bit late. The general attitude out of Washington is, "It's been advertised for 15 months, we've been waiting for it, it's arrived. So what." And Wall Street can't complain. Interest rates have collapsed, bonds have exploded, stocks have rallied, and the Fed has glued Chrysler and a few of the banks back together.Where's the big catastrophe?

So far, so good. Yet, I wonder—is this to be just another recession like 1958 or 1970 or even 1975? Or do we have something different here?

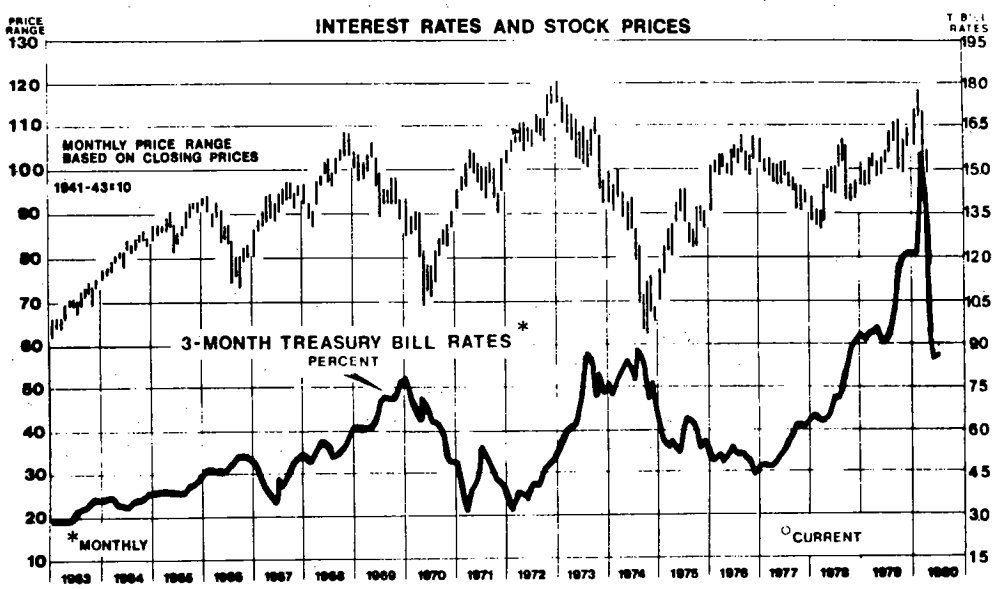
There is a spector, a nasty scenario that runs through my mind, and I wrote about it in Letter 750 (Feb. 14, 1979). This is what I said: *"Here's a little nightmare that I have. Somewhere during 1979 (or perhaps during early 1980) the US economy slips into mild recession. The recession is greeted by near-joy by Wall Street and business ('Ah, at last, a chance to make money in bonds and a big new low coming in stocks'). The recession then deepens, and a few major bankruptcies occur. The rate of inflation is at last declining, and this is greeted with loud hurrahs by the Government. But it is slowly dawning on people that the recession is turning nasty. Unemployment is rising. And more bankruptcies are announced.*

"Then, with a frightful suddenness (due to extremely low corporate liquidity) bankruptcies become rampant. A panic for cash is on. Almost overnight CASH becomes the crucial element in staying alive, and in a flash EVERYTHING IS FOR SALE—houses, cars, land, collectibles, even gold."

That's the nightmare, and I'll be frank—it's a recurring nightmare. It still bothers me.



The fact is that the US economy is growing progressively more unstable, more illiquid, more volatile with each successive cycle. The economy turns up, inflation roars, the Fed then steps on the



In the last Letter I referred to the lagging Transportation Average, but towards the end of the Letter I noted that the Transports had suddenly turned stronger. On May 14 the carriers spurted to a new recovery high of 260.11. At the same time it was the Industrials that began to show lagging tendencies. As Industrials approach the 831 halfway level I would expect to see a rather ragged market and a market which is moving into over-bought territory.

Conclusion: I see the action since March as part of a bear market rally. I explained in previous Letters that stocks were being "helped" by an up-cycle which took hold at the March 27 lows and this cycle should exert a generally positive influence until August. In mid-August the cycle turns down.

brakes and the economy caves in. Next, the Fed opens the floodgates again, the economy booms, and inflation and interest rates rush to new highs. And away we go again. Except that with each round trip, the danger increases and the results are less satisfactory.

We can see this "hysteria effect" on the accompanying chart (courtesy of S&P's "The Outlook"). And it is clear that the economy is acting like a giant motor that is in danger of shaking itself to pieces somewhere ahead. The only question is when: when does the flywheel bounce off into space, when does the crankshaft explode? The answer is that we are getting closer and closer, and as we do the danger increases.

Some call this whole process "Fed fine tuning." Some term it Federal Reserve bungling. Others call it "political-economics" and still others call it a roller-coaster ride to disaster. Whatever you want to name it, the chart shows the swings of the 91-day T-bill rates and the accompanying swings in the broad S&P 500 Stock Index. But note this—following each economic recession and market decline, the subsequent period of economic expansion took stock prices to successive new highs. That is, until recently! During the latest rise (1974-80), for the first time since World War II, a period of economic expansion and Fed stimulation (and it entailed tremendous Fed stimulation) FAILED to produce a new high in the S&P 500.

What does this mean? In my opinion, the failure of the S&P 500 to make a new high during 1977-80 is telling us that the various problems of US industry are now so chronic, so stubborn, so difficult, that literally no amount of inflation and rampant credit expansion is capable of taking the mass of stocks to new highs. To put it another way, more and more Federal Reserve Credit (with accompanying inflation) produces less and less in the way of real gains in either the stock market or the economy. Thus the US, it seems, is now running up the "down" escalator.

All right, now let's turn to the stock market itself (chart, page 1). What I believe we have been seeing since March is a bear market rally in which the market has been working off the effects of the concentrated "mini-crash" of February-March. Such rallies tend to *automatically* recoup about half of the losses sustained during the preceding panic-crash. Considering that the Dow dropped from a February peak of 903.83 to its April 13 low of 759.13, a recovery to around 831 would be the *normal*.

My guess is that the market will fluctuate rather erratically for the next few months with the Averages managing to hold above the March-April lows. I am expecting a broad and drastic decline to begin around August, a decline that could test the March-April lows by October.

If those lows hold on any test it will be a great relief to me, as it will mean that the worst of the recession has probably been discounted. But I am not hopeful about the March-April lows holding. My guess is that by the end of the year Wall Street will have all the problems it cares to deal with. As for me and my subscribers, I want again to urge a position of liquidity. This means staying with the Treasury bills, notes and bonds as explained in recent Letters.

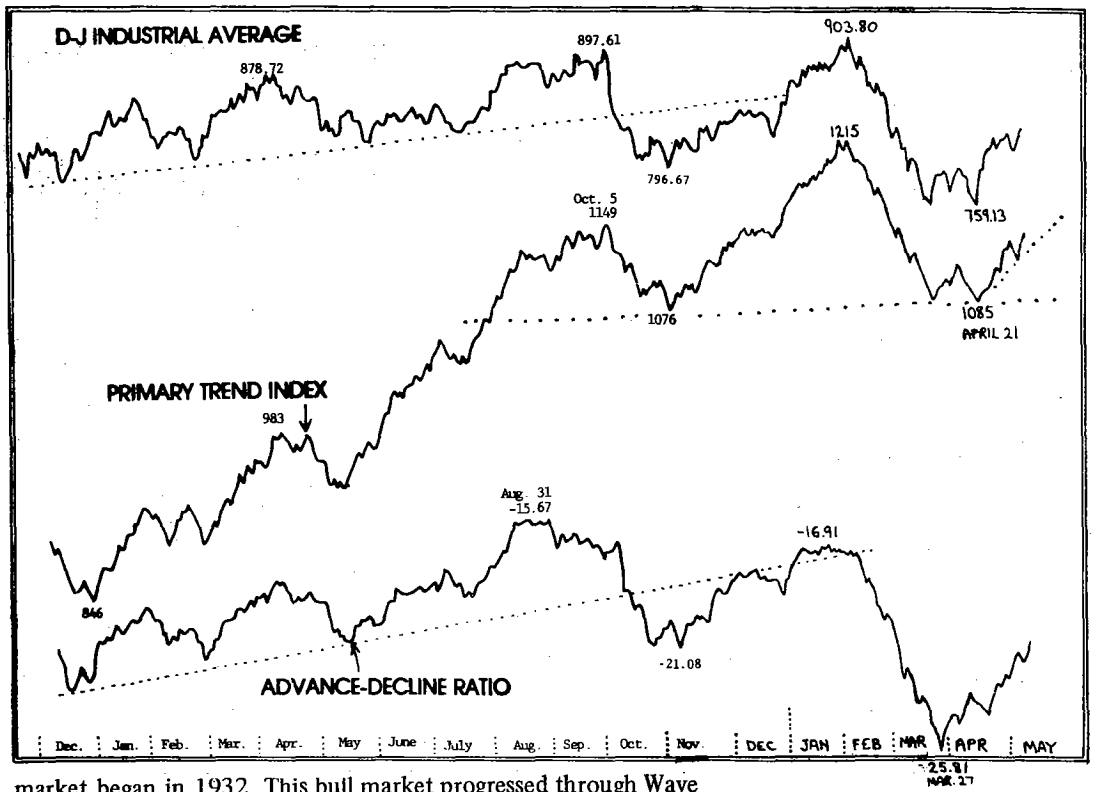
The Primary Trend Index (PTI) (see chart, p. 3), turned up from its April 21 low of 1085 and has formed a rising pattern. It isn't a terribly impressive pattern, but it is "up," and that's what counts. I've drawn a little rising trendline on the PTI, and what we want to see now is whether the PTI holds to its rising trend—or whether the trendline fails to hold.

On the larger picture, I mentioned in the last Letter that the PTI could be in the process of forming a huge "head-and-shoulders top." And it's possible that we are on the right shoulder now. If so, I would expect the PTI to start flattening out and faltering soon.

The A-D ratio (which is a proxy for all NYSE issues) has rallied to just under its November low. Since most stocks during the February-March smash broke below their November lows, the A-D is now telling us that we are nearing the zone where resistance to rise should be more evident. I would guess that the easy part of the rally is over.

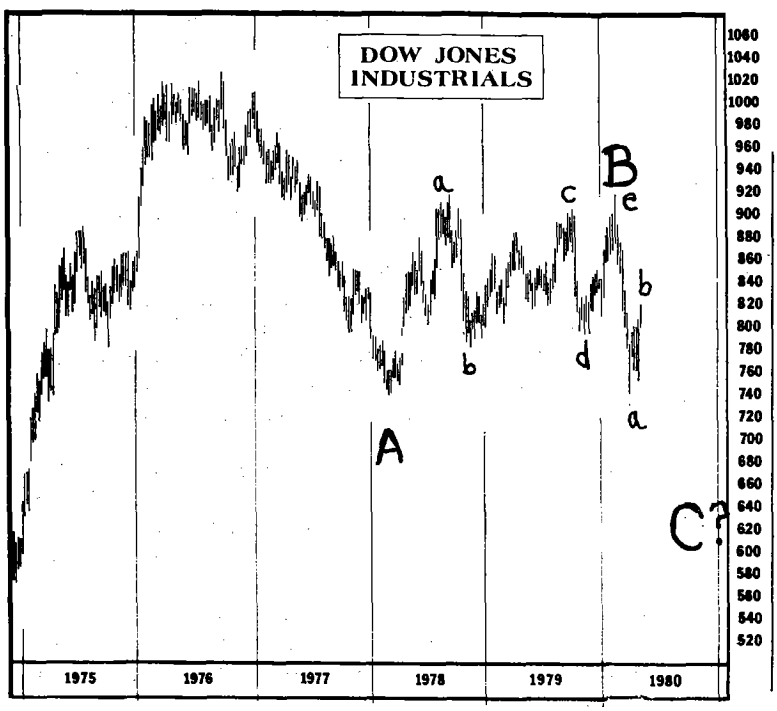
ELLIOTT: I always keep one eye on Elliott, regardless of what market I am puzzling over or thinking about. Elliott doesn't always work, it doesn't always supply the answers. But it has worked often enough to keep me studying it. In a few instances, Elliott has saved my life as far as the markets are concerned.

I talk to Bob Prechter every week or so, and Bob is probably the most knowledgeable Elliott Wave student in the US ("The Elliott Wave Theorist, PO Box 262, Chappaqua, NY 10514). Bob believes (and I tend to agree with him) that a giant Elliott bull



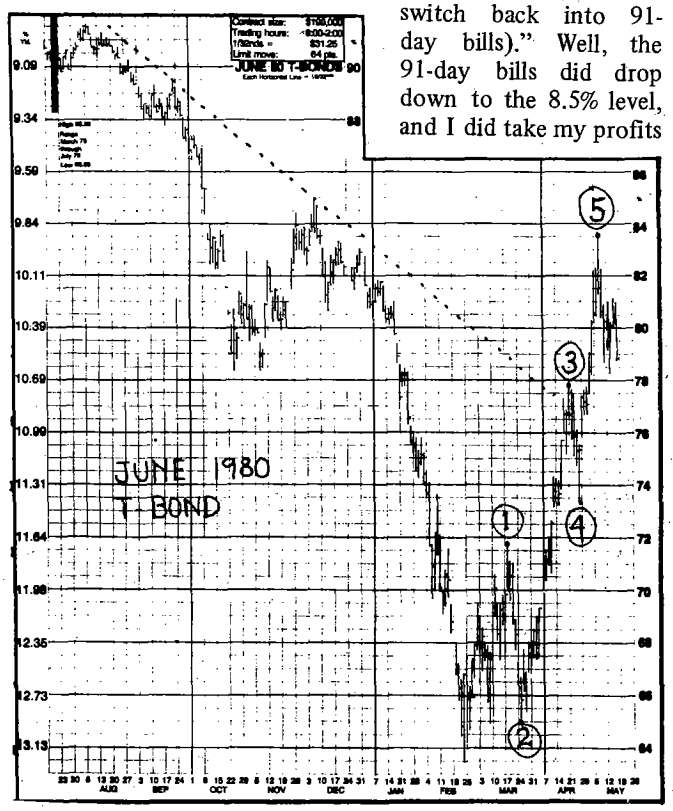
market began in 1932. This bull market progressed through Wave 1, 2 and 3 with the 3rd Wave ending for the Dow in 1966. From there corrective Wave 4 began, and that 4th Wave is still in force. The 4th Wave should end in an A-B-C pattern. The A wave (see chart) terminated in February, 1978. The B wave (sub-dividing as shown on the chart below) ended in January, 1980. We should now be in the final C Wave, and the C Wave should sub-divide into 5 smaller waves.

So far, this analysis makes sense on the chart, but unfortunately, if the final C leg is to be completed, the Dow has some more downside paths to travel. The termination of the current C Wave should take the Dow well below the current levels, if this interpretation of Elliott is correct. At any rate, I will continue to elaborate on Elliott during the critical corrective period ahead.



The good news: following giant corrective Wave 4 there should be a super-bull Wave 5. This is the wave which will ultimately (if it occurs) take stocks into the stratosphere. What will happen to bring about the 5th Wave? Easy: Russia falls apart economically, the US again assumes world leadership with the help of a strong President, moral re-birth, an explosion in productivity and a dollar officially convertible into gold at $2000 an ounce. Russia dumps Cuba as an expensive failed-experiment. An absurdly cheap oil-shale process is discovered and the biggest surprise of all–Saudi Arabia becomes the 51st State in the Union.

MONEY: In the last Letter I wrote that the money instruments were moving into the ripe-for-profits area. I stated that "if the shorter-term interest rates sink too far too fast (say 8% on 91-day T-bills) I'll sell my 2-year notes and take the profits (I'll then switch back into 91-day bills)." Well, the 91-day bills did drop down to the 8.5% level, and I did take my profits



My guess now is that we could see a pretty good correction with debt instruments giving back some of the sensational gains of the March-April upward explosion.

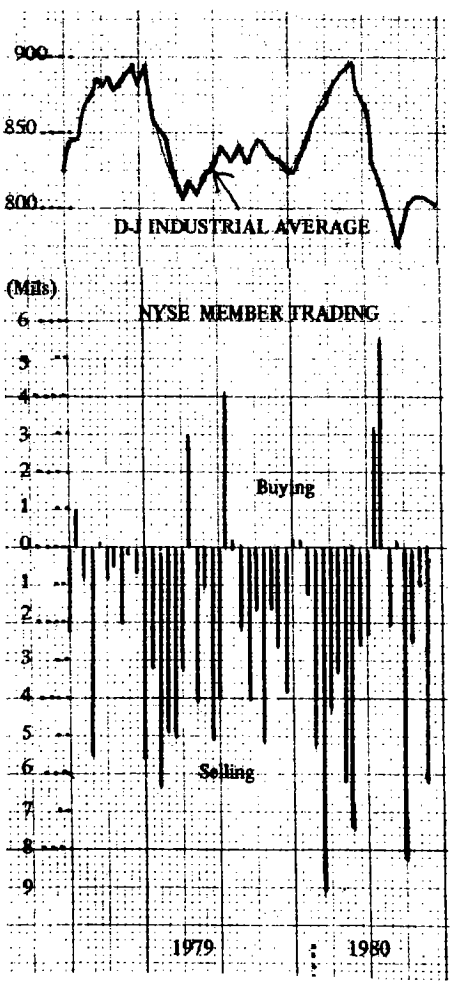
This chart (above) of the T-bond futures (June) tells me that the correction should be about ready to start. From the late-February low of 63.50, I count a perfect Elliott 5-wave pattern up to the early-May peak of 83.60. That sensational rise of 32% in a few months could be subject to a violent correction, and if

so, I would just as soon avoid it. At any rate, I "took the money and ran" but I will be a buyer following any sizeable correction in the money market. I'm not greedy. One or two plays like this year is more than enough for me. As I've so often written, I like making money and I don't look to the securities markets for my thrills. The interest rate collapse of March-April was a perfect money play, and we'll probably get another one before 1980 is out. (Chart courtesy Commodity Price Charts, 219 Parkade, Cedar Falls, Ia 50613).

Note: One small change in my advice from the last Letter. I would advise all those who take profits from the money market instruments to switch now to T-bills of 30 days maturity only. These can be bought in the open market.

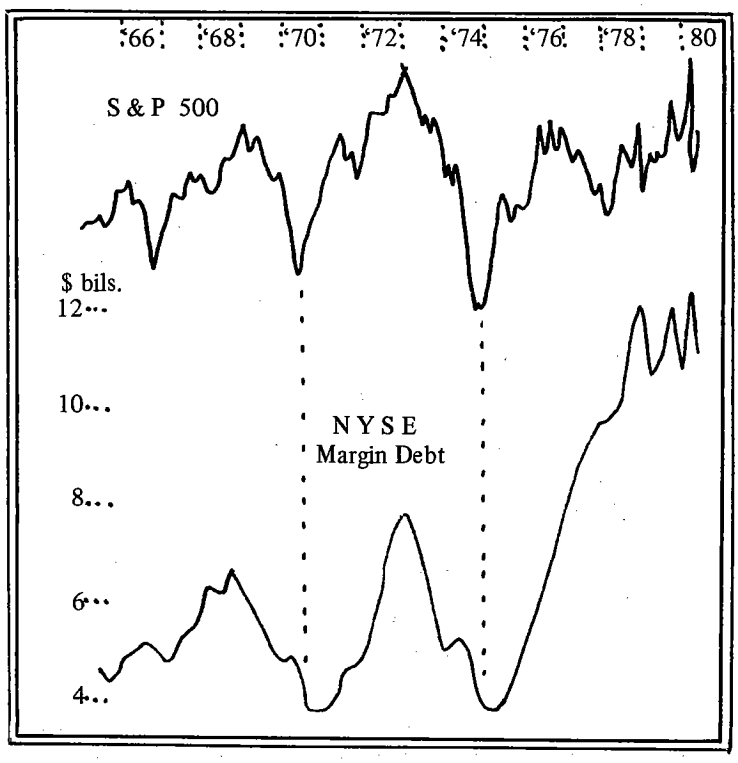
WAITING: I've been writing a lot of late about the major, cyclical bottom that is due (or should I say overdue) to arrive on Wall Street. Now to invest correctly at a major bottom you must possess three things: (1) perspective, (2) an understanding of the risk/reward concept, and (3) PATIENCE.

If you are aware of, and understand history, if you realize that the longer the time lapse after the last major bottom, the nearer you are to the next major bottom, then you possess perspective. On the other hand, if you lay awake nights telling yourself that "another great bottom will never arrive," if you are wringing your hands and mumbling to yourself that "Wall Street is different now," then you lack perspective–and ultimately you'll lose your shirt.



If you understand the concept of risk/reward, then you realize that you don't "have to be" in the stock market at all times. You also realize that the only time you should be in the stock market is when the potential reward far outweighs the potential risk. Risk is lowest and reward is greatest when you enter the stock market at or near a great, cyclical bottom.

If you possess patience you will treat your money and your investments the way any good businessman treats his business. If you lack patience, you will gamble with your money and hope the market and lady luck will smile on you. Lady luck, if you're depending on her, is your enemy in the stock market. She's your enemy because she'll keep you hoping instead of dealing with the facts. Winners in the stock market always deal with reality–what IS. Losers in the market deal with what "should be" and what "I hope will happen."



One of the characteristics of a major cyclical bottom is that it produces *distress*. It literally knocks the wind out of a great many stockholders and at the same time it scares them to death. This process results in large quantities of stocks being thrown on the market for "whatever they will bring." Thus, one important thing to watch for at a true market bottom is panic–stocks for sale at bargain prices.

When panic occurs we can look for two tell-tale phenomena. First, a severe drop in NYSE margin accounts. During panic bottoms, people don't want stocks and they certainly don't want stocks on margin. A second phenomenon is that the NYSE specialists tend to "stabilize" the market near panic lows. They do this by buying stock (which they hope to unload on the next rally). On top of this, at or near panic lows the NYSE Exchange members tend to accumulate stocks. Consciously or unconsciously the members know that collapsing prices and panic conditions always produce *bargains*. So the members love to buy the stocks that the public throws in during those rare periods of panic.

In view of these two phenomena, the accompanying charts are discouraging. They are discouraging because they are clear in saying that no major, cyclical bottom has appeared during 1979 and 1980. The margin chart shows that NYSE margin currently outstanding is near record highs–unlike conditions in 1970 and 1974 (both of these periods saw major stock market lows).

The second chart shows that except for a few scattered weeks, Exchange members have been selling their heads off all during 1979 and 1980. If there was any accumulation of "bargain stocks," it certainly does not show on my chart. And it should.

Therefore, my advice is to understand that this market has not traced out a major or important bottom so far during 1979 or 1980. That's the perspective. Therefore what is needed is patience. The rest is up to you.

NOTES & QUOTES: A few years ago (during VietNam) it was suggested that one way to end the conflict was simply for Washington to announce that "We Won" and immediately pull our troops out. Carter learned the lesson well. According to *Newsweek* (May 12) he may be heading for the same kind of solution for the hostages. I include the *Newsweek* comment below:

Playing Down the Hostage Crisis

Carter Administration sources are hinting to reporters that they should consider devoting less attention to the Iranian hostage issue. The hostages may be in Iran for a long time to come, White House insiders suggest; life goes on and Americans should think of other things as well. This judgment was a factor in President Carter's decision to start campaigning outside Washington. It also could have occurred to the Carter camp that the less the voters see and hear about the Iran crisis, the less it may affect the November elections.

* *

As most readers of these reports know, it's my opinion that the great majority of people don't really want to make money. What they do want is–excitement. And that's exactly the way they operate in the security markets, jumping in and out on market rallies and declines, losing more money in options, dumping their hard earned, after-tax salaries on the latest "hot tip."

I've always maintained that gambling is stupid. Nevertheless, it makes more sense for most people than does their current money management system. It makes more sense because there's more excitement in Vegas or Atlantic City than there is on Wall Street, and certainly gambling at the tables is more efficient (it takes less time to lose your money, and you don't have to fool with commissions). Organized gambling is the perfect way of separating the public from its money. You don't believe it? All right, study this little news clip, showing that gambling in the State of Nevada alone took over half a billion dollars from willing suckers during the first quarter of 1980!

Nevada Gamblers Lose $579.5 Million

CARSON CITY, Nev. (UPI)—Gamblers lost $579.5 million in Nevada's casinos during the first three months of 1980, an $81.2-million increase over the same period last year.

"It's not comparable to the 20% increases a couple years ago, but it's pretty darn good," Jack Stratton, chief of the Nevada Gaming Control Board's audit division, said Friday.

* *

Farm prices are down 10% compared with the same period in 1979 and total farm income is running 17% behind 1979. This is adding up to a disaster for many farmers and sales of farm equipment are now diving. Farming can thus be added to the casualty list along with autos and housing.

* *

You can count on it: unemployment is going to be the centerpiece of this recession. The 1974-75 recession started from an unemployment low of 4.6%. This recession began from an unemployment base of 5.7%. But the changing relationship between GNP and employment has suggested to some economists that the 9% unemployment reached during May, 1978 would be comparable to 12% in this recession. If 12% unemployment is approached, you're going to hear ominous comparisons being made between "the 1980's and the 1930's."

* *

Book jacket of the year: Pat Oliphant's new political cartoon gallery entitled: "Oliphant!" The cover shows Ted Kennedy behind the wheel, with Jimmy Carter in the back seat in a wet suit–and looking very, very nervous.

I've talked about collectibles from time to time, and the collectible which probably has the best record over the years is choice US stamps. There's been some correction over the past month in a few categories of stamps, but in general big money continues to go into both art and stamps. If you doubt it, study this clip from Linn's Stamp News, showing that three blocks (12 stamps) of the US Pan American issue (these are rare freaks with inverted centers) brought $450,000 at auction on April 29.

Inverts net $450,000

A group of 1-cent, 2¢ and 4¢ Pan American inverted center stamps in blocks of four netted an aggregate $450,000 April 29 at an auction conducted by Sotheby Parke Bernet Stamp Auction Co. in New York City, according to an Associated Press wire story. The 1901 philatelic errors depicting upside-down modes of transportation brought $220,000 for the 2¢ block; $150,000 for the 4¢ group; and 1¢ for the $80,000 block. (This illustration is only a representation of the stamp and was not actually included in the sale.)

VAN GOGH OIL SELLS FOR A RECORD $5.2 MILLION

NEW YORK (AP)—A Vincent van Gogh oil painting entitled "Garden of the Poet" was sold at auction for $5.2 million Tuesday, the highest price ever paid for an impressionist painting, according to Christie's auction house.

It was also the highest price ever paid for a painting auctioned in the United States, breaking the record set Monday when a Picasso was sold here for $3 million, and was a record for any work not done by an Old Master, Christie's said.

May 13, 1980

Speaking of collectibles how's this tid-bit. Ironically, Van Gogh in his entire lifetime sold only one of his paintings, and that was to a friend.

* *

Latest Riddle: What's the biggest country in the world? Answer: Cuba–its capital is in Russia, its army is in Africa and its people are in the US.

GOLD, SILVER: "Cycles" magazine (124 S. Highland Ave., Pittsburgh, PA 15206) is a non-profit organization dedicated to the study of cycles. I have been reading this valuable magazine for many years. In the latest issue cycles publishes an interesting chart of the silver cycle, a cycle which I mentioned last week in connection with commodity man Walt Bressert.

'Actually, the silver cycle runs on a 5.58 year basis. The chart which I show here was obviously drawn prior to the January, 1980 top in silver, but it is worth noting that the article in Cycles comments that the "ideal crest of the 5.58 year (silver) cycle is 1980.04, or January, 1980." And that was, as they say, "right on."

The next consideration is that there is (or has been) about a 3-year span between the high in silver and the succeeding cyclical low. This implies that it could be 1983 before silver is ready for its cyclical bull move. Furthermore, since silver and gold tend to move together, we can draw the same conclusion regarding gold (at least from the cycle standpoint).

However, it should be remembered that cyclical time spans have mainly to do with the timing of ideal highs and lows and little

to do with the amplitude of the moves from high to low. Thus, even if the 5.58 cycle should hold, it does not mean that gold, for instance, cannot rise to new highs prior to 1983. It simply means that gold would be rising against the 5.58 silver cycle (which is in a downtrend) and the extent of any gold rise (against the cycle) would probably be less than if the cycle forces were now bullish.

I include a second chart, an arithmetic chart which presents a rather striking picture of gold. What I find so significant here is the giant accelerating rise to the January, 1980 top, then the smash below 500, and finally the consolidation formation in the 472-550 area.

What bothers me more than anything else about gold now is that when you get a spear-point top such as this one, then an initial crash from the highs, the first consolidation is simply a stop-off place prior to a continuation of the decline. I know of few instances wherein the initial smash from a spear-point constituted the whole of the decline. The second leg down may be milder, it may be much less in amplitude than the first leg, but there is almost always a second leg down.

Now many people argue that "gold is different," gold is money and money cannot be expected to act like sugar or copper or a common stock. But my own experience tells me that everything is subject to the laws of markets (supply and demand, accumulation and distribution), and that is what bothers me about the gold picture now.

The gold market has now turned very quiet. It would seem that the forces of supply and demand are now very much in equilibrium. My exponential moving averages of gold are also approaching the equilibrium area. The 5-week MA has held at 516 to 519 for three weeks in a row. The 13-week MA (still declining) is at 540, and the 50-week MA (rising about 2 points per week) is at 465. Thus all three MA's are now in the 465 to 540 zone, a zone range of 75 points. You can almost "feel" the gold barometer probing for the next major impulse.

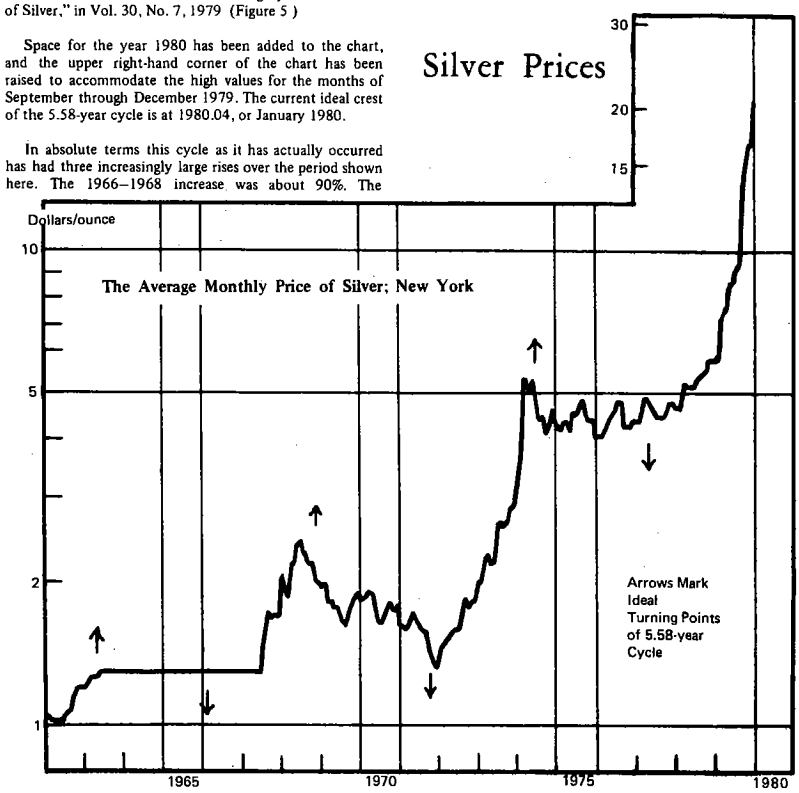
Interest in gold is widespread now (but not intense). The magazines and newspapers are filled with gold bullion, stock and advisory ads, and the talk about possible gold confiscation (by the government) has all but disappeared. Local dealers tell me that the public interest in buying gold coins has dropped dramatically (the public hates dull markets), and I've been tempted to pick up some coins myself "just for the hell of it." But I'm waiting. That spear-point chart of gold bothers me–it has an "unfinished" look. People who deal in markets should engrave in their brains the old Chinese proverb, "All comes to him who waits."

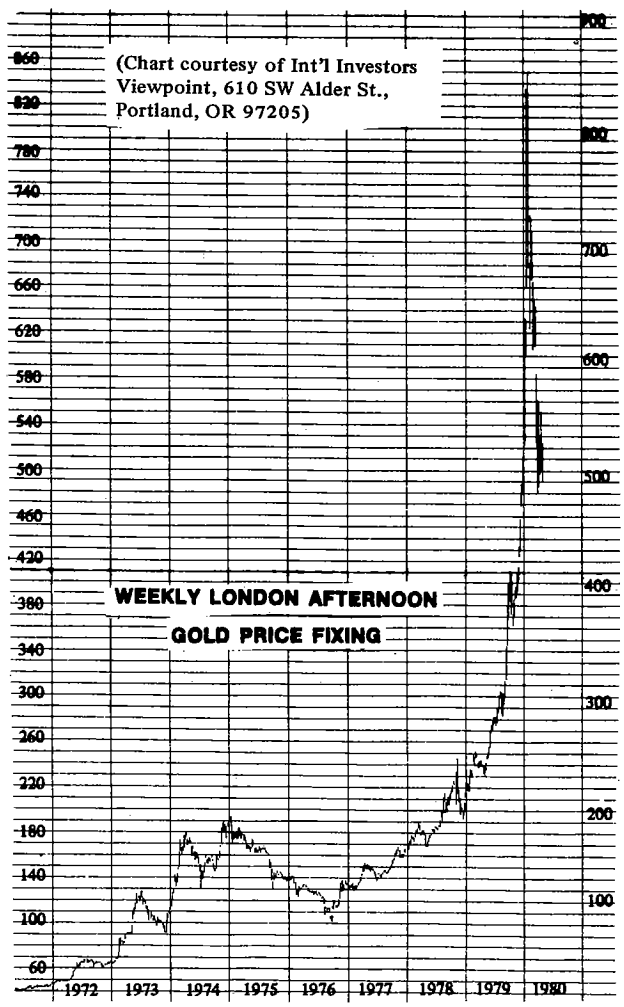
LATE NOTES: The economic skies are blackening, but the market foresaw all this when it smashed during February and March. Meanwhile, interest rates, money supply figures and currency prices fluctuate erratically, sometimes wildly. Daily new highs (NYSE) hold surprisingly low on the rally so far–thereby making the upside look feeble. But my PTI pushes higher, even though the rise in the PTI has so far been very gingerly, very "careful." As I've written before, there will be no market decline while the PTI keeps pushing higher, and the PTI has not issued any warnings–yet. A most interesting period with many bulls aggravated because their trading picks have gone nowhere, and many bears anxious because the market has refused to fall apart. I'm playing the waiting game . . . .

The chart below shows the average monthly price of silver at New York, beginning with January 1962 when the price was $1.045 per troy ounce, and ending with December 1979 when the price was $21.793. The arrows on the chart mark the ideal crests and troughs of a 5.58-year cycle. This chart was first used in the article "Long Cycles in the Price of Silver," in Vol. 30, No. 7, 1979 (Figure 5)

Space for the year 1980 has been added to the chart, and the upper right-hand corner of the chart has been raised to accommodate the high values for the months of September through December 1979. The current ideal crest of the 5.58-year cycle is at 1980.04, or January 1980.

In absolute terms this cycle as it has actually occurred has had three increasingly large rises over the period shown here. The 1966–1968 increase was about 90%. The 1971–1974 increase was over 300%. The recent increase (starting at August 1977) has amounted to about 390% so far. Although there are other cycles present in these figures, the 5.58-year cycle has clearly been dominant for almost two decades. An important benchmark for this cycle occurs in early 1980. *G. Shirk*





NEXT MAILING: June 4th